



U.S. Small Business Administration

The Facts About ... Starting a Small Business

Starting and managing a business takes motivation, desire and talent. It also takes research and planning. Lack of planning is one of the leading causes of business failures. Developing a business plan will walk you through the questions that every prospective or new business owner should answer. Before you start your plan, carefully research and answer these basic questions:

- What niche will my business fill?
- What services or products will I sell?
- Is my idea practical, and will it fill a need?
- Who is my competition?
- What is my business's advantage over existing firms?
- Can I deliver a better quality service?
- Can I create a demand for my business?

- **Once you've determined that your idea is feasible, answer these questions:**
 - What skills and experience do I bring to the business?
 - What will be my legal structure?
 - How will my company's business records be maintained?
 - What insurance coverage will I need?
 - What equipment or supplies will I need?
 - How will I compensate myself?
 - What are my resources?
 - What financing will I need?

- Where will my business be located?
- What will I name my business?
- **If you are starting a home-based business, you will want to answer these additional questions:**
- Does my home have the space (preferably separate) for a business?
- Can I successfully run the business from my home?
- Can I deal with the isolation of working from home?

- **Your answers to these questions will help you create a focused, well-researched business plan that should serve as a blueprint. The plan should detail how the business will be operated, managed and capitalized. Research Resources**

Some questions you will be able to answer on your own, others will require careful research. There are many sources available to help you find the answers and make informed decisions. The SBA's business information centers, located throughout the country, offer the latest in high-technology hardware, software and telecommunications to help you in your research. BICs offer electronic bulletin boards, computer databases, on-line information exchange, periodicals and brochures, counseling, videotapes, reference materials, texts, start-up guides, application software, computer tutorials and interactive media. One-on-one counseling with seasoned business veterans is available through the SBA-affiliated Service Corps of Retired Executives, also known as SCORE. Other sources include -

- trade association studies, journal articles and trade shows;
- regional planning organization studies on growth trends;
- banks, realtors and insurance companies; and
- customer surveys in your market area, which you can conduct on your own or may already exist.

- **The Business Plan Your business plan should cover the business basics.**

Executive Summary

- Describe in detail the business and its goals.
- Identify the business ownership and the legal structure.
- Discuss skills and experience you and your partners bring to the business.
- Identify advantages you and your business have over your competitors.

- **Operations**

- Explain how the business will be managed on a day-to-day basis.
- Discuss hiring and personnel procedures.
- Discuss insurance, lease or rent agreements, and issues pertinent to your business.
- Account for the equipment necessary to produce your products or services.
- Account for production and delivery of products and services.

- **Marketing**

- Describe your products/services.
- Identify the customer demand for your product/service.
- Identify your market, including its size, location and demographics.
- Explain how your product/service will be advertised and marketed.
- Explain your pricing strategy.

- **Financial Management**

- Explain the source and amount of initial equity capital.
- Estimate start-up costs.
- Project operating expenses.
- Develop a monthly operating budget for the first year.

- Develop an expected return on investment (ROI) and monthly cash flow for the first year.
- Provide projected income statements and balance sheets for a two-year period.
- Discuss your break-even point.
- Explain your personal balance sheet and method of compensation.
- Discuss who will maintain your accounting records and how the records will be kept.
- Provide "what if" statements that address alternative approaches to any problem that may develop.

- **Legal Requirements**

Small businesses must comply with federal, state and local laws and regulations. You need to be informed about the legal requirements affecting your business. Be sure to check with your state department of labor and county government. You may want to consult with an attorney for additional compliance assistance. Registration and accounting requirements: You may need a -

- work certificate or a license from the state (your business's name also may need to be registered with the state),
- sales tax number, and
- separate business bank account.

- **If your business has employees, you are responsible for -**

- withholding income and social security taxes, and
- complying with laws covering employee health and safety and minimum-wage.

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The U.S. Business Advisor, a World Wide Web site found at <http://www.business.gov>, can help you identify and comply with federal regulations, and links you to the Internal Revenue Service, the Social Security Administration, the Occupational Safety and Health Administration, and numerous other federal agencies. You

can also obtain federal tax information by calling the IRS at 800-TAX-FORM.

A home-based business is subject to many of the same laws and regulations affecting other businesses and some additional ones also.

Zoning: Be aware of your city's zoning regulations. If your business operates in violation of them, you could be fined or closed down.

Restrictions on certain goods: Most states outlaw home production of fireworks, drugs, poisons, explosives, sanitary or medical products, and toys. Some states also prohibit home-based businesses from making food, drink or clothing.

Understanding Your Market Market evaluation is critical and provides the basic data that will determine if and where you can successfully sell your product or service. This process involves defining your goals, scrutinizing your competition and your customer base, and interviewing potential suppliers. The information collected can help you, if necessary, adapt your product or service to better meet customer needs. Market research can help you -

- create primary and alternative sales approaches to a given market,
- make profit projections from a more accurate database,
- organize marketing activities,
- develop critical short/mid-term sales goals and establish the market's profit boundaries, and
- identify your differential advantage, i.e., what makes your business different from similar businesses with similar products.

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Questions To Ask Your research should answer these basic questions:

- Who are your customers?
- Where are they located?
- What are their needs and resources?
- Is the service or product essential in their operations or activities?
- Can the customer afford the service or product?

- Where can you create a demand for the service or product?
- Can you compete effectively in price, quality and delivery?
- How many competitors provide the same service or product?
- What is the general economy of your service or product area?
- What areas within your market are declining or growing?

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Research on competitors is extremely important. Visit industry trade shows to find out what your competitors are selling and how they are marketing their products. Similarly, stay current on industry magazines and publications.

Do not view market research as a one-time activity. Once you establish your business, you should continually be in touch with your customers. You may have to adapt your product/service and/or marketing strategy to keep up with your customers' changing needs.

Pricing Your Products and Services There are several pricing strategies; select the approach that will make your goods or services the most competitive and will help you reach your profit goals.

Retail Cost and Pricing A common pricing practice among small businesses is to follow the manufacturer's suggested retail price. The suggested retail price is easy to use, but it doesn't adequately account for the element of competition.

Pricing Below Competition This strategy reduces the profit margin per sale; it requires you to reduce your costs and -

- obtain the best prices possible for merchandise,
 - locate the business in an inexpensive location or facility,
 - closely control inventory,
 - limit product lines to fast-moving items,
 - design advertising to concentrate on price specials, and
 - limit non-essential services.
- **One word of caution: pricing goods below the competition can be difficult to sustain because every cost component must be**

constantly monitored and adjusted. It also exposes you to pricing wars. A competitor can match the lower price, leaving you out in the cold.

Pricing Above Competition This strategy is possible when price is not the customer's greatest concern. Considerations important enough for customers to justify paying higher prices include -

- service considerations, including delivery, speed of service, satisfaction in handling customer complaints, knowledge of product or service, and helpful, friendly employees;
- a convenient or exclusive location; and
- exclusive merchandise.

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Price Lining This strategy targets a precise segment of the buying public by carrying products in a specific price range only. For example, a store may wish to attract customers willing to pay over \$50 for a purse. Price lining has certain advantages:

- ease of selection for customers;
- reduced inventory; and
- reduced storage costs, due to smaller inventory.

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Multiple Pricing This approach involves selling a number of units for a single price, for example, two items for \$1.98. This is useful for low-cost consumer products, such as shampoo or toothpaste. Many stores find this an attractive pricing strategy for sales and year-end clearances.

Cost Factors and Pricing Every component of a service or product has a different, specific cost. Many small firms fail to analyze each component of their commodity's total cost, and therefore fail to price profitably. Once you do this analysis, set your prices to maximize profits and eliminate any unprofitable service.

Cost components include material, labor and overhead costs. Material costs are the costs of all materials found in the final product, such as the wood, glue and other materials used in manufacturing a chair.

Labor costs are the costs of the work that goes into the

manufacturing of a product. An example would be the wages of all production-line workers producing a certain commodity. The direct labor costs are derived by multiplying the cost of labor per hour by the number of personnel hours needed to complete the job. Remember to use not only the hourly wage but also the dollar value of fringe benefits. These include social security, workers' compensation, unemployment compensation, insurance, retirement benefits and so forth.

Overhead costs are any costs not readily identifiable with a particular product. These costs include indirect materials, such as supplies, heat and light, depreciation, taxes, rent, advertising, transportation and insurance. Overhead costs also cover indirect labor costs, such as clerical, legal and janitorial services. Be sure to include shipping, handling and/or storage as well as other cost components. Part of the overhead costs must be allocated to each service performed or product produced. The overhead rate can be expressed as a percentage or an hourly rate. It is also important to adjust your overhead costs annually. Charges must be revised to reflect inflation and higher benefit rates. It's best to project the costs semiannually, including increased executive salaries and other projected costs.

Understanding Cash Flow Failure to properly plan cash flow is one of the leading causes of small business failures. Understanding the basics will help you better manage your cash flow. Your business's monetary supply can exist either as cash on hand or in a business checking account available to meet expenses. A sufficient cash flow covers your business by meeting obligations (i.e., paying bills), serving as a cushion in case of emergencies, and providing investment capital.

The Operating Cycle The operating cycle is the system through which cash flows, from the purchase of inventory through the collection of accounts receivable. It measures the flow of assets into cash.

For example, your operating cycle may begin with both cash and inventory on hand. Typically, additional inventory is purchased on account to guarantee that you will not deplete your stock as sales are made. Your sales will consist of cash sales and accounts receivable credit sales, usually paid 30 days after the original

purchase date. This applies to both the inventory you purchase and the products you sell. When you make payment for inventory, both cash and accounts payable are reduced. Thirty days after the sale of your inventory, receivables are usually collected, increasing your cash. Now your cash has completed its flow through the operating cycle, and the process is ready to begin again.

Current Assets Cash and other balance-sheet items that convert into cash within 12 months are referred to as current assets.

Typical current assets include cash, marketable securities, receivables and prepaid expenses.

Cash-Flow Analysis Cash-flow analysis should show whether your daily operations generate enough cash to meet your obligations, and how major outflows of cash to pay your obligations relate to major inflows of cash from sales. As a result, you can tell if inflows and outflows from your operation combine to result in a positive cash flow or in a net drain. Any significant changes over time will also appear. Understanding this will lead to better control of your cash flows and will allow adequate time to plan and prepare for the growth of your business.

It is best to have enough cash on hand each month to pay the cash obligations of the following month. A monthly cash-flow projection helps to identify and eliminate deficiencies or surpluses in cash and to compare actual figures to past months. When cash-flow deficiencies are found, business financial plans must be altered to provide more cash. When excess cash is revealed, it might indicate excessive borrowing or idle money that could be invested. The objective is to develop a plan that will provide a well-balanced cash flow.

Planning a Positive Cash Flow Your business can increase cash reserves in a number of ways.

- **Collecting receivables: Actively manage accounts receivable and quickly collect overdue accounts. You stand to lose revenues if your collection policies are not aggressive. The longer your customer's balance remains unpaid, the less likely it is that you will receive full payment.**

- Tightening credit requirements: As credit and terms become more stringent, more customers must pay cash for their purchases, thereby increasing the cash on hand and reducing the bad-debt expense. While tightening credit is helpful in the short run, it may not be advantageous in the long run. Looser credit allows more customers the opportunity to purchase your products or services. You should measure, however, any consequent increase in sales against a possible increase in bad-debt expenses.
- Taking out short-term loans: Loans from various financial institutions are often necessary for covering short-term cash-flow problems. Revolving credit lines and equity loans are types of credit used in this situation.
- Increasing your sales: Increased sales would appear to increase cash flow. However, if large portions of your sales are made on credit, when sales increase, your accounts receivable increase, not your cash. Meanwhile, inventory is depleted and must be replaced. Because receivables usually will not be collected until 30 days after sales, a substantial increase in sales can quickly deplete your firm's cash reserves.

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Finding an Accountant If you decide to hire an accountant, find someone who is knowledgeable, capable and discreet. With the ever-changing complexities of tax laws and developments in accounting methods, it is important to look for an accountant who takes advantage of educational seminars, professional publications and other continuing-education opportunities. Professional accountants are listed in telephone directories under accountants, public accountants, bookkeepers and tax preparers. Look for references or recommendations from local business associates, your banker or attorney.

Raising Money For a Small Business One key to a successful business start-up and expansion is your ability to obtain and secure appropriate financing. Raising capital is the most basic of all business activities.

There are several sources to consider when looking for financing. Explore all of your options before making a decision. These include -

- personal savings,
- friends and relatives,
- banks and credit unions, and
- venture-capital firms.

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Borrowing Money To be successful in obtaining a loan, you must be prepared and organized. You must know exactly how much money you need, why you need it and how you will pay it back. You must be aware of the bank's loan policies. Lending institutions generally require fully secured loans and sufficient commitment of capital by the borrower.

Types of Business Loans **Short-Term Loans:** Short-term loans are paid back in less than one year. Types of short-term loans are -

- working-capital loans,
- accounts-receivable loans and
- revolving lines of credit.

- **Long-Term Loans:** Long-term loans have maturities greater than one year but usually less than seven years. Real estate and equipment loans may have maturities of up to 25 years. Long-term loans are used for major business expenses, such as -

- equipment,
- furniture and fixtures,
- vehicles,
- commercial mortgages and
- real estate.

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Applying For a Loan Approval of your loan request depends on how well you present yourself, your business plan and your financial needs to a lender or investor. The best way to improve your chances of obtaining a loan is to prepare a thoughtful and professional-looking proposal. The proposal is your business plan with a few important additions:

- In the Executive Summary, state the purpose of the loan and the exact amount required. Explain specifically what the loan will be used for and why it is needed.
- In the Financial Information section, include personal financial statements on yourself and other principal owners of the business if this will be a partnership. Also identify the collateral you would be willing to pledge as security for the loan.

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What Lenders Look For Many loan officers will order a copy of your credit report from a credit-reporting agency. Therefore, you should work with these agencies to help them present an accurate picture of yourself. The lender will also look at your work history and letters of recommendation. Using the credit report and the information you have provided, the lending officer will consider the following issues:

- Do you have a sound record of credit-worthiness?
- Do you have sufficient experience and training to operate a successful business?

- Have you prepared a loan proposal and business plan that demonstrate your understanding of, and commitment to, the success of the business?

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SBA Financial Assistance Programs The SBA offers a variety of financing options for small businesses. The SBA's assistance usually is in the form of loan guaranties. The SBA guarantees loans made by banks and other private lenders to small business clients. Generally, the SBA can guarantee up to \$750,000 or 75 percent of the total loan value, whichever is less. The average size of an SBA-guaranteed loan is \$175,000, and the average maturity is about eight years.

Whether you are looking for a long-term loan, a general working-capital loan, a revolving line of credit or a microloan, the SBA has a financing program to fit your needs.

For More Information Information is power. Make it your business to know what is available, where to get it and, most importantly, how to use it. Sources of information include:
U.S. Small Business Administration

- SBA District Offices
 - SBA OnLine (electronic bulletin board)
 - Business Information Centers (BICs)
 - One-Stop Capital Shops (OSCSs)*
 - Service Corps of Retired Executives (SCORE)
 - Small Business Development Centers (SBDCs)
 - U.S. Export Assistance Centers (USEACs)*
 - Women's Business Centers (WBCs)*
- *Inquire at your local SBA office as to availability.

- **The SBA has offices located throughout the United States. For the one nearest you, look under "U.S. Government" in your telephone directory, or call the SBA Answer Desk at 1-800-U-ASK-SBA. To send a fax to the SBA, dial 202-205-7064. For the hearing impaired, the TDD number is 704-344-6640. For information on your rights to regulatory fairness, the telephone number is 1-800-**

REG-FAIR.

To access the agency's electronic public information services, you may contact:

SBA OnLine: electronic bulletin board (modem and computer required)

- 1-800-697-4636 (limited access)
- 1-900-463-4636 (full access)
- 202-401-9600 (D.C. metro area)
- **Internet: using uniform resource locators (URLs)**
 - SBA home page: www.sba.gov
 - SBA gopher: <gopher.sba.gov>
 - File transfer protocol: <ftp.sba.gov>
 - Telnet: <telnet.sba.gov>
 - U.S. Business Advisor: www.business.gov
- **You also may request a free copy of The Resource Directory for Small Business Management, a listing of for-sale publications and videotapes, from your local SBA office or the SBA Answer Desk.**
- **Other Sources**
 - State economic development agencies
 - Chambers of commerce
 - Colleges and universities
 - Libraries
 - Manufacturers and suppliers of small business products and services
 - Small business or industry trade associations
- **SBA Goals & Objectives**
 - Increase opportunities for small business success

- Transform the SBA into a 21st century leading-edge financial institution
- Help families and businesses recover from disasters
- Lead small business participation in welfare-to-work
- Serve as a voice for America's small business
- **Did you know that in fiscal year 1997 the SBA -**
 - maintained a guaranteed-loan portfolio of more than \$29 billion in loans to 200,000 small businesses that otherwise would not have had such access to capital?
 - backed over 49,400 loans totaling a record \$10.9 billion to America's small businesses?
 - made a record 2,700 investments worth \$2.37 billion through its venture capital program?
 - provided a record 50,000 loans totaling \$1.1 billion to disaster victims for residential, personal-property and business losses?
 - extended management and technical assistance to nearly 900,000 small businesses through its 12,400 Service Corps of Retired Executive volunteers and approximately 1,000 small business development center locations?
 - assumed a leadership role in the Administration's Welfare to Work Initiative by encouraging entrepreneurship and linking small businesses with potential employees?
- **Did you know that America's 23 million small businesses -**
 - employ more than 50 percent of the private workforce,
 - generate more than half of the nation's gross domestic product, and
 - are the principal source of new jobs?
- **CO-0028 (04/98)**